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CENTRAL INTELLIGENCE AGENCY

OFFICE OF NATIONAL ESTIMATES

3 April 1969

MEMORANDUM FOR THE DIRECTOR

SUBJECT: The Iranian Oil Dispute

NOTE

The Shah and the Consortium of Western oil companies* are at a new crisis in their continuing controversy over oil revenues. The immediate dispute concerns the amount of payments for the Iranian year 1348 (21 March 1969 - 20 March 1970). The Shah wants $1 billion; the Consortium's figure is $900 million. This difference can probably be compromised, though ill feeling between the two sides makes this less than certain. In any event, similar issues will arise again, perhaps in less tractable form. This paper examines the sources of dispute, as well as possible future developments and their implications for US interests.

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| * British Petroleum | 40% | |
| American Companies | 40% | (7% each for the 5 majors and 5% divided among 8 smaller companies) |
| Royal Dutch/Shell | 14% | |
| Companie Francaise des Petroles | 6% | |

GROUP 1
Excluded from automatic downgrading and declassification

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Background

1. In recent years, the Shah and the Consortium have had increasingly bitter differences about the oil revenues that Iran should receive. In March 1968, the companies agreed to provide $865 million for the Iranian year 1347 (21 March 1968 - 20 March 1969), the first year of Iran's Fourth Five-Year Plan. The Shah accepted this compromise figure but insisted that he would look to the companies for a total of $5.9 billion for the entire Plan period. This would mean an average increase of about 16 percent annually. The Consortium is operating on the premise that business conditions will permit them to provide a total of some $5.0 billion over this period, representing a revenue increase of about 8 percent per year. Talks during the past year have failed to budge either side significantly. The negotiations are now in recess until 10 May 1969 while the two parties reconsider their positions.

2. While the Consortium finds production in Iran profitable, Iranian oil is at a geographical disadvantage in comparison with North African and Nigerian crude for

the lucrative European market and its moderately high sulphur content diminishes its attractiveness in pollution-conscious Japan. Moreover, the oil companies believe that to meet the Shah's demands would give Iran a heavily disproportionate share of the yearly increase in total Persian Gulf oil output.* This would threaten their interests in other oil-producing states of the area and would hinder further efforts to develop new sources of supply in some of the smaller states of the Persian Gulf. The oil companies are also convinced that if the Shah broke with them he could not find other outlets for his oil in anything like the quantities needed to provide the revenues he seeks. Hence they feel in a strong bargaining position.

3. For his part, the Shah considers that rapid economic development is essential to Iran's continuing stability and to the preservation of the monarchy. He is looking to petroleum revenues for about 80 percent of the public sector funds committed to the Development Plan. Since the cost of major

* Iran currently produces about 25 percent of the oil shipped from the Persian Gulf. The Shah's demands would amount to over 75 percent of the increase now projected by the companies for future years.

development projects is rising well beyond Plan estimates, the Shah is especially insistent that the Consortium meet his demands. He contends that Iran deserves preferential treatment with respect to oil revenues. He argues that his country is not only stable itself but is a force for stability in the area, that it has proved its competence in the efficient use of income for economic and social development, and that Iran has been a reliable friend both to the US and to the Consortium in times of crisis (as when it provided increased quantities of oil when Arab producers shut down during the June 1967 War). The Shah urges that considerations like these should persuade the US Government to see that his views prevail in his dispute with the Consortium.

The Current Crisis

4. The immediate dispute concerns the amount of revenue for the Iranian year 1348 (21 March 1969 - 20 March 1970). The Shah wants $1 billion in revenue; the Consortium is willing to offer only $900 million. If this were the only issue, one could be reasonably confident of a compromise. Consortium members have already hinted to the US that they would come

part way, and the Shah has no possible alternative outlet that would get him anything close to his asking price. Moreover, Iran has a profitable arrangement for the sale of natural gas to the USSR, and this gas is produced only as oil continues to flow.

5. But the situation is complicated by a number of factors. [redacted] 25X1

25X1 This will further embitter the climate of negotiations. Moreover, both parties are concerned about the implications of any present agreement for bargaining in future years. The companies are particularly reluctant to give in for fear of leading to an unbridgeable gap between the Shah's demands and what they are willing to provide in the last years of the Development Plan.

6. In this situation, there is always the possibility that irrationality will prevail. The Shah's prestige is engaged in the bargaining process, and both sides may overestimate their

alternatives. The companies are confident of their ability to meet the needs of their consumers even without Iranian oil, but they have consistently been conservative in estimating the growth of consumer demand. For his part, the Shah is probably overoptimistic about his ability to find new outlets if he were to break with the Consortium; certainly the USSR and Eastern Europe could not soon fill the gap. Nevertheless, we believe that for the present, the two parties recognize their interdependence sufficiently that they will make a deal covering this year.

Possible Developments

7. But the dispute over revenues will be a continuing one. As time goes on, each side is likely to see more opportunities to get on without the other. New oil discoveries will increase the diversity of the companies' sources and make them considerably less dependent on Persian Gulf oil. In this situation, the rate of increase in production in the Middle East may be far lower than at present, compounding the difficulties of bargaining with the Shah.

8. The Shah too will no doubt be able to expand his alternatives to the Consortium. The National Iranian Oil Company (NIOC), which last year produced about $22 million in revenue, may in a few years be able to increase this substantially. The newly formed German oil combination is interested in purchasing oil for about 25 percent of the West German market; the Germans have already begun preliminary talks with NIOC about supplying part of this. Iran probably will also be able to step up its sales somewhat to Rumania and other East European countries; the Shah has already concluded deals to commence in the early 1970s that will be worth somewhere in the neighborhood of $200 million over several years.

9. Should he desire, there are also several more or less punitive measures the Shah could take against the Consortium. For example, he could repossess some of the undeveloped portions of the concession to offer to other oil concerns. Inasmuch as there is probably oil in some of these areas, he would not have great difficulty in attracting bids. Another possible measure would be to force the companies to let him purchase a share in the Consortium. It would of course be difficult to set an agreed price, and this procedure -- like repossession of parts of the

concession area -- would generate great friction in relations with the companies, and would probably discourage them from increasing their investment in Iran. Yet the stakes on both sides are high enough that they would probably find it expedient to continue present operations for some years to come.

10. An outright break with the Consortium would seriously affect US relations with Iran. The Shah would hold the US to some degree responsible. He would probably seek economic aid from the US Government to make up any serious shortfall and would also sharply step up his demands for concessional terms in acquiring US military equipment. He might use US installations as a bargaining lever to this end. Nevertheless, we believe that the Shah would seek to maintain a balance in his relations between the US and the USSR, and this would keep him from anything approaching a complete break with the US.

FOR THE BOARD OF NATIONAL ESTIMATES:

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ABBOT SMITH
Chairman